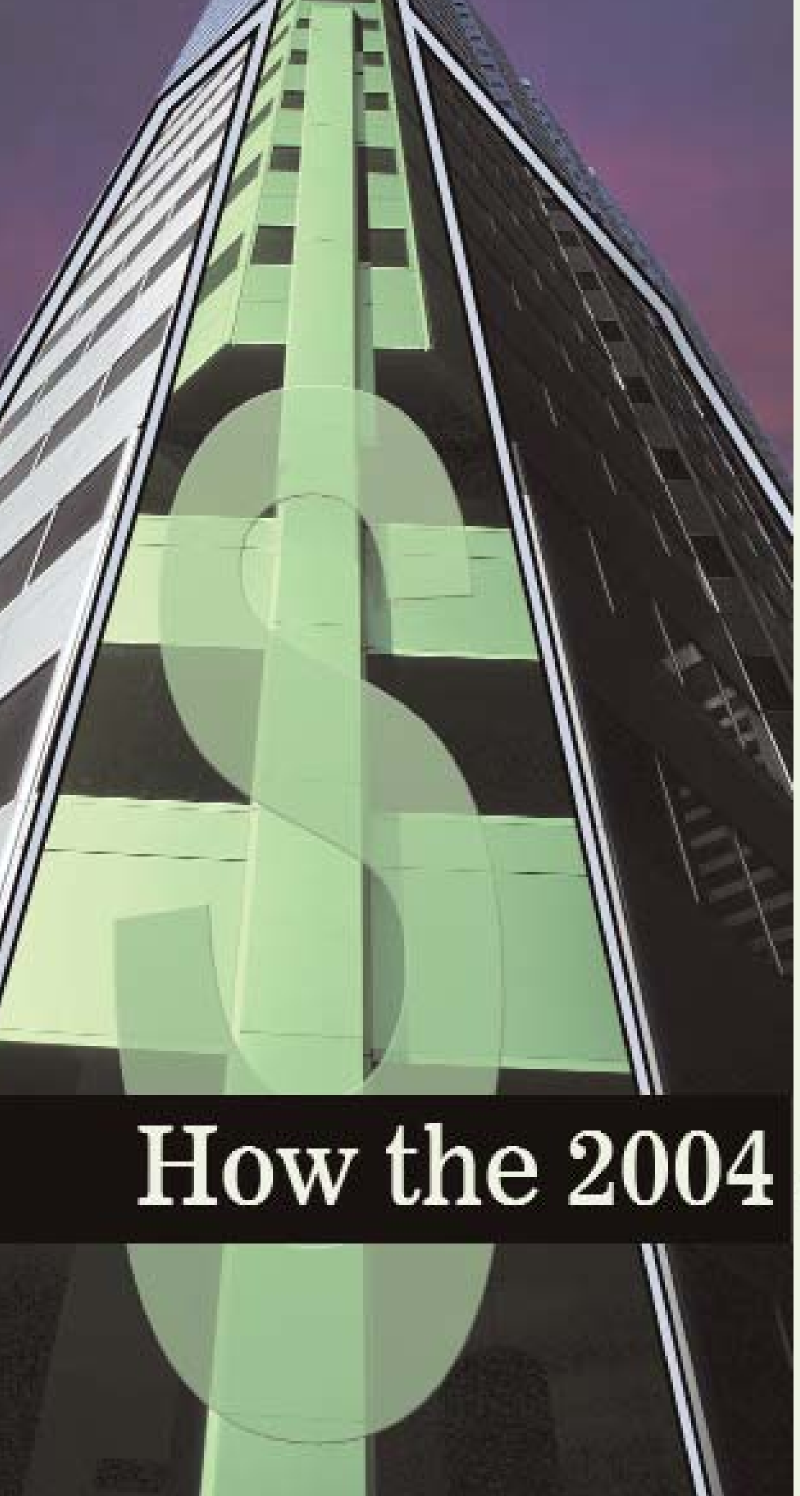

How the 2004 Job Act Affects Businesses

By Richard Shavell, CPA

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On Oct. 22, 2004, the President signed into law the American Jobs Creation Act of 2004. This massive tax law replaces the U.S. export tax regime with broad-based tax relief for domestic manufacturing and other businesses and industries including the construction industry.

Here's what you need to know right now about the more widely applicable tax changes for businesses in this important new law.

• New deduction for U.S. production activities. The Jobs Act creates a new tax deduction for domestic production activities. The deduction is a percentage of the net income from these activities-3% in 2005-2006, 6% for 2007-2009, 9% after 2009-but it is subject to several limitations.

The new deduction is allowed for qualified production activities income, which is the domestic production gross receipts of a business net of related expenses. "Domestic production gross receipts" includes receipts from any lease, rental, license, sale, exchange, etc., of qualifying production property (i.e., tangible personal property among other items) that was manufactured, produced, in whole or in significant part by the business within the U.S. Included are receipts from construction in the U.S., as well as engineering and architectural services performed in the U.S. for construction projects in the U.S.

Complex allocation rules will apply if only part of a business's gross receipts are domestic production gross receipts. The deduction is available to regular (C) corporations, passthrough entities such as S corporations and partnerships, and to sole proprietorships, estates, and trusts.

• Robust expensing tax breaks extended for two more years. A business that buys machinery and equipment generally deducts its cost over a number of years via depreciation. The expensing election permits a business or practice to expense (that is, deduct immediately rather than depreciate over several years) a certain amount of the cost of tangible depreciable personal property purchased and placed in service during the year. The maximum annual expensing amount is $100,000 (adjusted for inflation), and the maximum annual expensing amount begins to phase out dollar-for-dollar when the business or practice places in service during the tax year expensing-eligible property in excess of $400,000 (adjusted for inflation).

Before the 2004 Jobs Act, these rules only applied for tax years beginning in 2003 through 2005. After 2005, the maximum expensing amount was scheduled to drop to $25,000, and the expensing phase-out figure was set to drop from $400,000 to $200,000. Under the 2004 Jobs Act, the $100,000/$400,000 amounts (adjusted for inflation) will stay in place through tax years beginning before 2008.

• New 15-year write-off for qualifying leasehold improvements and qualifying restaurant property.

Effective for property placed in service after Oct. 22, 2004, and before Jan. 1, 2006, the Jobs Act permits 15-year straight line depreciation for qualifying leasehold improvements and qualified restaurant property. In general terms, qualifying leasehold improvements are interior improvements made under a lease to commercial property (such as an office building or warehouse), and placed in service more than three years after the building was first placed in service. Certain structural improvements don't qualify, nor do expansions. Also, improvements made by a building owner usually won't produce a fast write-off for a subsequent owner.

Qualified restaurant property is any improvement to a building if the improvement is placed in service more than three years after the date the building was first placed in service and more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals. In general, qualifying leasehold improvements and qualifying restaurant property were written off over a 39-year period under prior law.

• Limited expensing write-off for heavy SUVs. Heavy SUVs - those with a gross vehicle weight rating (GVWR) of more than 6,000 pounds - are not subject to the "luxury auto" depreciation dollar caps and lease income inclusion amount rules. Under the rules that applied before the 2004 Jobs Act, this meant that the entire cost of a heavy SUV used 100% for business could be written off under the expensing rules. Effective for vehicles placed in service after Oct. 22, 2004, only $25,000 of the cost of a heavy SUV may be expensed.

• New limit on company deductions for entertainment, etc., provided to officers and directors. For expenses incurred after Oct. 22, 2004, the Jobs Act limits a company's trade or business deduction for costs of entertainment, amusement, or recreation-related goods, service or facilities it provides to officers, directors, and 10%-or-more owners. The costs are deductible only to the extent that they don't exceed the amount of expenses treated by the company as compensation income to the recipient as a result of receiving those goods, services, or facilities. The Act overturns a court decision holding that a company could deduct the entire cost of providing entertainment, amusement, or recreation-related goods, services or facilities, regardless of whether that cost was greater or less than the amount that the recipient had to treat as income.

Please keep in mind that we've described only the highlights of the most important changes in the new law. Contact your tax advisor for more details on how you may be affected by this important tax legislation.